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Section I

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IN THIS ISSUE

How We Plan, Set Up and Operate Our Budget, by René J. Bernard ... 575

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EDITORIAL DEPARTMENT NOTE

Past issues of the *N. A. C. A. Bulletin* have contained many articles dealing with the fundamental principles of budgetary control, and most of our members are rather familiar with these fundamental concepts. It is in the application of these principles to a specific situation that most of our difficulty arises. It is often helpful in such cases to know what practices are followed by other concerns in developing budget figures and in operating the budget. No two situations are exactly the same, but usually there is something in the other fellow's experience which can, with modifications perhaps, be of help to you. With this thought in mind, we are presenting in this issue an article dealing with some features of budgetary control as practiced by the firm of Sargent & Co.

The author of this article is René J. Bernard, who was educated at St. Ann's Academy, New York City. His business experience began with the Standard Gas Light Co. of New York City, and he had attained the position of Office Manager with this concern when he left them after ten years to become Assistant Treasurer of the Cosmos Dyeing and Printing Works, Inc., of Paterson, N. J. Shortly afterwards Mr. Bernard gave up this position to enter public practice, spending ten years as staff senior with Touche, Niven & Co. and R. G. Rankin & Co. Since 1931 he has been Controller of Sargent & Co., of New Haven, Conn.

Mr. Bernard is a member of our New Haven Chapter and is at present serving as Associate Director of Membership. He is a New York C. P. A., and the author of articles on various accounting subjects which appeared in *The American Accountant*.

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NATIONAL ASSOCIATION OF
COST ACCOUNTANTS

FEBRUARY 1, 1936

HOW WE PLAN, SET UP AND OPERATE OUR BUDGET

By René J. Bernard, Controller,
Sargent & Co., New Haven, Conn.

THE term "budget," as applied to business today, is comparatively modern. It signifies putting on paper in an orderly way a carefully detailed plan having in view the probable future trend of the business, together with a definite method of controlling that plan. Forecasts should not reflect desired or ideal conditions. The budget should be probable as well as possible, rather than unattainable.

There is nothing new in principle about the practice of budgeting for the basic idea is as old as man. The only new aspect is the way the term is applied. Practically all businesses since their very existence have been, at one time or another, compelled to prepare some form of a budget system whether they dignified such planning or forecasting by that name or not. Today when these plans and forecasts attain a certain degree of completeness or perfection, they are known as budgets.

Government Points the Way to the Budget

The need for a budget was first formally recognized in governmental organizations due to the steadily mounting taxation burden which had come to be a matter of serious concern. It became evident that advanced control of expenses was essential in order to reduce taxes to the minimum. The theory of the budget—that expenditures must not exceed receipts—was fully recognized.

Foreign governments, notably England, were among the first to adopt the budget system. Our own government was one of the last of the great countries to fall in line. The World War precipitated a situation which compelled us to recognize and appreciate the potential benefits which may be had from planned operations and to adopt the budget system. Even then twelve years elapsed from the time the budget was first proposed until the Budget and Accounting Act was passed by Congress and became a law.

The fact that it required twelve years from the time the govern-

ment's budget was first proposed until it became a law in 1921, is conclusive evidence that the preparation of a budget of any magnitude requires considerable time for the planning, figuring, and analyzing essential to its ultimate success. The budget of the government establishes its revenue requirements, while in business the reverse is true, i.e., budgets are set so that expenditures will not exceed revenue.

Federal Bureau Established

The first government budget effort was initiated during the administration of President Taft, in December, 1909, when an appropriation of $100,000 was made for a commission to investigate the possibilities of a budget system. The commission was appointed in September, 1910, and in June, 1912, the need for a national budget was recognized, but the recommendation made at that time was shelved by Congress a year later.

In 1916, the platforms of all parties favored a budget. The first bill to establish a Bureau of the Budget was passed in 1920 and vetoed by President Wilson. The bill was repassed by Congress and the Budget and Accounting Act became a law on June 10, 1921. On December 5, 1921, President Harding sent the budget to Congress for the fiscal year ended June 30, 1923.

Industry Adopts the Budget

Business being confronted with post-war disaster took refuge in the budget about 1920 but many, who had not yet fallen in line by the time the depression began in 1929, realized the paramount importance of better control of their business and accordingly accepted the budget as their guide. If the business was to survive, intelligently prepared forecasts were a necessity. It became the accepted theory that these forecasts should be based on past experience interpreted in the light of present conditions and future expectations. While history is "water gone over the dam," it is, and must be, the basis of all budgeting.

Important Limitations of the Budget

Our interest in budgets emanates from our natural desire to forecast the future. The budget is based on estimates and measures the probable expectancy of performance. Unfailing estimates can-

not be made, because it was never intended for us to foresee the future, but the budget is our best attempt. Furthermore, forecasts *per se* are influenced by the frame of mind of the forecaster who might be inclined toward unjustifiable optimism or pessimism. The absolute ideal is not attainable in any human activity. Variations are bound to creep in, particularly in setting budgets. It may be assumed, therefore, that we cannot expect infallibility in our prophecies. Budgets must be used with judgment and not followed blindly. While there will always be human uncertainties to reckon with, business forecasts can, with proper application of judgment and common sense, result in a reasonably accurate forecast of future business conditions. As some one has expressed it, "If there is one truth which the philosophy of business should teach us, it is the truth that the only certainty in business is its positive uncertainty. The one changeless law is the rule that business is constantly changing." As Ralph Waldo Emerson puts it, "Time pulverizes into shining ether the hard regularity of facts."

It is a fundamental and practical truth that we must constantly look ahead to the problems that confront industry and business if we wish to progress in this world. Evaluating the future is one of the first requisites of good budgeting. A keen vision is essential to pierce the future. A budget system helps to focus the eyes forward instead of backward. What the future holds for us is important since that is where we are headed. To quote Thomas J. Watson, "We should think about the future because that is where we are going to spend the rest of our lives."

In the recent past many executives were satisfied with historical statements of what had been done, but today management realizes the far greater importance of gauging the probable trend of the business so that due preparation may be made to meet future conditions as they develop. The budget has become the searchlight of business.

Analyzing a Business

In analyzing a business our interest is in determining where we stand today as a result of past performance and, from a financial standpoint, what may reasonably be expected in the future. The information we seek is:

1. How do we stand? Hence, the balance sheet.

2. How did we get there? Hence, the profit and loss statement.
3. Where do we go from here? Hence, the budget.

The balance sheet and the profit and loss statement reveal the available facts of past performance, and, hence, are the natural approach to the detailed data required to guide the business into more profitable channels. The minute analyses of these historical statements enable us to translate "hindsight" into "foresight." After all, history is not any good, as Henry Ford says, unless it teaches us something. It is just like experience.

The Sales Forecast

The key to the entire budget is the sales forecast. The information entering this forecast is the most difficult to determine, because it is in a large measure beyond control. The usefulness of the entire budget hinges on its dependability. In spite of the difficulties involved we have found it possible to make a reasonably accurate sales forecast. A weighing of available barometers of business and economic conditions coupled with proper judgment in interpreting past performance has pointed the way to future expectations.

In our company the sales forecast is made by the sales manager and approved by the management. It comprises a careful study of previous sales for a number of years analyzed by months into product classes to show seasonal trends. This information is essential for sound planning of production. It is also modified by a study of general conditions in the industry; reports of our salesmen as to the volume of inventories of our customers who distribute our products; and a country-wide survey of general business conditions which might have an effect on our particular industry. At frequent intervals, our sales executives call on our distributors. The first-hand information as to probable consumer demands which they obtain influences the forecast. We also make use of a monthly analysis of our unfilled order balance by "shipable dates."

Production Forecast

The anticipated sales having been determined, the production program follows. The proper correlation of production and sales is the foundation of efficient inventory control. Some of our prod-

uct is affected by seasonal trends and, naturally, production must take these trends into account. A review of the sales for a number of years reveals these trends, thus production may be planned so that goods will be on hand when needed.

Stability of production is a desirable goal. The production budget of our company is laid out on a straight-line basis throughout a six-month period, in an endeavor to avoid peaks and valleys in production. Economical operation and stabilization of production and employment naturally follow because employees knowing approximately what their earnings will be are more satisfied labor turnover is reduced, and a better product at a lower cost is the result.

While it is unprofitable to produce more goods than can be sold within a reasonable time after production, it seems wise to manufacture in economical units within limits fixed by the possibility of obsolescence and mark-downs. On the other hand the theory of increased production to decrease cost is a fallacy. If this policy is followed in the face of prospects that do not warrant it, the actual result may be a loss to the company or a break in market prices, or both. Our production is held in check to a minimum consistent with economical manufacturing quantities to avoid building up an inventory beyond potential needs and beyond the point where it is in line with our incoming business, actual and prospective.

Advantages of the Production Budget

Advantages resulting from a properly operated production budget are:

1. Inventories are maintained at a reasonably low level and unreasonable obsolescence and mark-downs guarded against.
2. Excessive inventories, necessitating write-down adjustments due to market price declines, are avoided.
3. Low inventories increase turnover, thereby retaining assets in a more liquid state.
4. With production schedules based on anticipated sales, raw material requirements can be established beforehand, thereby obtaining better prices and better deliveries.
5. Production is concentrated on goods that should be on hand when required by the trade.

6. Uniform production results in decreased costs and enhances the goodwill of employees and customers.

The necessary costs to meet the production program are determined and gauged by the elements of labor, material and overhead in the cost of sales of the year just ended, and these cost components and sales are then adjusted to the basis in effect at the first of the year. An illustration of how the results of a prior year can be used to determine the percentage of the various cost elements to sales and direct labor cost is contained in Exhibit 1.

The Monthly Production Forecast

We now have the basis for determining our cost of production at standard, and by adjusting standard for excess direct labor, material price variations and over- or under-absorbed overhead, the total production cost is obtained. The factory production forecast is developed from the above basis as follows:

	January	*February*	*March*
Net Sales	$260,000	$250,000	$275,000
Basic Cost of Sales:			
Direct Labor—net 16.98% of Sales	$ 44,148	$ 42,450	$ 46,695
Materials 22.50% of Sales	58,500	56,250	61,875
Overhead:			
Fixed	28,000	27,600	28,000
Variable 15.24% of Sales	39,624	38,100	41,910
	$170,272	$164,400	$178,480
Add:			
Excess direct labor, 6% of net direct labor	2,652	2,550	2,805
Unabsorbed overhead, 4% of variable overhead	1,576	1,500	1,690
Estimated production cost	$174,500	$168,450	$182,975

At the end of this article will be found a series of 24 forecast statements, illustrating the way in which we go about the preparation of budget forecasts. The factory production forecast, which is Statement No. 3 of this series, shows the above cost elements broken down in more detail into direct labor, materials, factory supplies and expenses, and fixed charges.

The procedure for predetermining the cost elements of labor, material and variable overhead in our product, as illustrated above,

	Direct Labor	Material	Overhead Fixed	Overhead Variable	Overhead Total	Total	
Net Sales-actual							$3,070,000
Cost of Sales- actual	$561,600	$668,600	$336,000	$494,400	$830,400	$2,060,600	
Deduct:							
Excess Direct Labor	31,800					31,800	
Unabsorbed Overhead				19,000	19,000	19,000	
Cost of Sales at standard-actual (Direct labor and material are at actual cost; overhead is at standard cost)	$529,800	$668,600	$336,000	$475,400	$811,400	$2,009,800	
Adjustment of year's operations to basis in effect on January 1:							
Net Sales:							
Sales prices were advanced 5% on May 1, which basis is still in effect on January 1. Sales prior to the advance amounted to $1,000,000. Therefore 5% of $1,000,000-							50,000
Materials:							
The material cost in the December 31 inventory, which is also the market cost, is 5% in excess of the material cost in the year's cost of sales. Therefore 5% of $668,600 -		$ 33,400				$ 33,400	
Year's operations as adjusted at standard cost to basis in effect January 1	$529,800	$702,000	$336,000	$475,400	$811,400	$2,043,200	$3,120,000
% of Cost Elements to Net Sales	16.98%	22.50%	10.77%	15.24%	26.01%	65.49%	
% of Cost Elements to Net Direct Labor	100.00%	132.50%	63.42%	89.73%	153.15%	385.65%	

EXHIBIT 1

has proven to be very reliable, and its dependability is substantiated by the cross section of our goods which we cost quarterly in total. This is attributed to the fact that the percentage of sales of each of our product classes has proven to be a fairly uniform ratio to the total year's sales. If activity in any product exceeds the normal in any period, then a compensating deficit will always follow, because experience shows a tendency for variations to equalize. It is realized that this principle may not work in all businesses but the slight discrepancy in our inventory at the end of the year is sufficient proof that our procedure is sound.

Cost of Sales

We determine our monthly cost of sales on the same basic principles outlined in the foregoing for determining our production cost, except that the principle of "first in, first out" is observed.

We do not cost individual invoices, but cost every three months, in total, a representative cross section of our goods. The cost ratios to sales as determined are then applied to the respective sales of each product class, thereby obtaining the standard cost of sales for the period. To illustrate:

Product Class	*Sales in Cross Section*	*Standard Cost of Sales of the Cross Section*		*Total Sales of the Month*	*Standard Cost of the Month's Sales*	
		Amount	*%*		*Amount*	*%*
1.	$ 55,000	$36,000	65.45	$108,333	$ 70,903	
2.	28,000	18,000	64.29	41,667	26,788	
3.	20,000	13,120	65.60	30,000	19,680	
4.	37,000	24,500	66.22	70,000	46,354	
	$140,000	$91,620	65.44	$250,000	$163,725	65.49

The cross section classification is sufficiently broad so that these averages do not vary too radically. The whole theory is based on the law of averages. Any variation between the basic principle used in costing our monthly sales, as explained fully under "Production Forecast," and the cross section, is adjusted in the succeeding months.

This plan, as here outlined, has been in use for several years and has operated very efficiently and with better results than anticipated.

To illustrate how we would cost the January sales, let us assume that the elements of cost in the December 31 inventory are the same as the adjusted standard cost of sales of the prior year, i.e.,

65.49%. Let us further assume that the January sales amounted to $250,000; the earned net direct labor, $45,000; the excess direct labor, $3,000; and the total factory overhead, $68,000. The cost of sales for January would be determined as follows:

Standard cost of sales, 65.49%		$163,725
Add excess direct labor		3,000
Overabsorbed or unabsorbed overhead:		
January net direct labor	$45,000	
Standard overhead at 153.15%	$68,918	
Actual overhead	68,000	
Overabsorbed overhead	$ 918	
January cost of sales		$166,725

You will observe that the overabsorbed overhead of $918 is not taken as a credit in the January cost of sales. The reason for this is that the standard overhead is in the inventory at 153.15% of the net direct labor and the end of the year inventory must be disposed of before credits can be passed to cost of sales for overabsorbed overhead. However, if unabsorbed overhead had been created in January, it would have been added to cost, because actual cost was in excess of standard cost. Similarly any overabsorbed overhead resulting after the end of the year inventory was exhausted would be credited to cost.

Any changes in the cost elements that may arise are immediately reflected in the estimated cost of sales. Similarly any variations detected, when the cross section of our goods is costed, are recognized.

There is but a very negligible difference between either of our costing methods, indicating that both procedures are reliable. The closeness of our estimated inventory to the physical inventory at the end of the year substantiates our confidence in our monthly cost estimates.

It is realized that some will disagree with our procedure in obtaining our monthly cost of sales, but, nevertheless, the method is practicable and is proving satisfactory in actual experience. The fact that our inventory variation is a fraction of one per cent would indicate that this scheme has merit.

The departmental burden rate of each of our manufacturing departments is set up as a certain percentage of net direct labor.

In our hypothetical illustration, it was determined that the standard burden of all the manufacturing centers was 153.15% of the net direct labor. The actual overhead for January was less than 153.15% since overabsorbed overhead was created. If this condition of the factory operating under standard continues, it will necessitate valuing the inventory at a lower basis than the current standard overhead ratio.

Exhibit 2 illustrates the departmental controllable expense report which we prepare and submit to our foreman after the close of each month. The causes for any material variation between actual performance and the budget is briefly accounted for, and steps taken to adjust such variances.

This report has served us well in reducing factory overhead.

Inventory Control

Inventory control comprehends producing that which is called for by the sales forecast, giving due consideration to manufacturing efficiency.

For a number of years prior to the depression from which we are now emerging, factory production had little or no regard for potential consumption, resulting in excess inventories, which, in many cases, soon became obsolete, necessitating heavy mark-downs or scrapping with the consequent loss of capital and, perhaps, ultimate failure. This state of affairs must inevitably lead to the survival of the fittest and the elimination of the weakest. Coordination of production with sales might well be the determining factor between financial success and failure. It follows that business success to a large extent rests on the effectiveness with which the inventory is controlled. To illustrate the importance of inventory control, assume that a company's operating results for one year resulted in a net profit of $50,000, and that the normal inventory should amount to $125,000. A 20% over-production on this basis would tie up $25,000 or 50% of the year's profits. Should obsolescence result from this excess production, the profit would be further reduced or the loss increased.

Determining Per Cent of Variability in Expenses

In determining the percentage of variability in expenses, the expenses were broken down in detail for some months past and ad-

DEPARTMENT _____

COMPARISON OF
DEPARTMENTAL CONTROLLABLE EXPENSES
WITH THE BUDGET

MONTH OF _____

NATURE OF EXPENSES	ACTUAL			BUDGET			REMARKS
	Amount		% to labor	Amount		% to labor	
STANDARD DIRECT LABOR							
CONTROLLABLE EXPENSES:							
Excess Direct Labor							
Indirect Labor							
Manufacturing Supplies							
Repair Labor							
Repair Supplies							
Spoilage,							
Changes, Defects and Shortages							
TOTAL CONTROLLABLE EXPENSES							

_____
FOREMAN

EXHIBIT 2

justed to the basis now in effect. The sales of the same period were similarly adjusted to the current level. In setting up the budget it was assumed that the sales of the period being forecasted would increase as much as 25%. It was on this basis that the expenses were budgeted. To illustrate how this was done, using the hypothetical figures shown on the forecasts of selling expenses, which are part of this paper, we have:

Nature of Expenses	*Monthly expenses on sales of $250,000 (expenses and sales adjusted to current levels)*	*Anticipated variability in expenses on 25% increase in sales*		*Forecasted expenses on sales of 125% of current volume*
		%	*Amount*	
Rent	$ 1,000	..	.....	$ 1,000
Taxes	1,000	..	.....	1,000
Commission	300	25	$ 75	375
Freight	2,500	10	250	2,750
Miscellaneous	12,500	Various	925	13,425
	$17,300		$1,250	$18,550

	Sales	*Expenses*	*% of Variability*
Current Volume	$250,000	$17,300	
25% increase	312,500	18,550	
Difference	$ 62,500	$ 1,250	2%

The per cent of variability is, therefore, 2%. The variable and fixed expenses are determined as follows:

Net Sales	$250,000	$312,500
Total Expenses	$ 17,300	$ 18,550
Variable Expenses, 2% of net sales	5,000	6,250
Fixed Expenses	$ 12,300	$ 12,300

In every undertaking, whether in business or at home, expenses may be divided into fixed, semi-variable, or wholly variable expenses. Semi-variable expenses may be further broken down into fixed or wholly variable, so that there will be but two classifications of expenses, i.e., fixed and wholly variable. The above illustration shows expenses of each nature; rent and taxes are fixed; freight, semi-variable; and commission, wholly variable. The per cent of variability in selling expenses (salaries and depreciation are not included here) has been determined to be 2%, and $12,300 is the amount of the fixed expenses.

Interpreting Profit and Loss Statements

Many comparisons of profit and loss statements are meaningless mainly because the actual volume of sales fails to conform to the anticipated. If sales were forecasted perfectly, a comparison could be had, but, unfortunately, fluctuations are a certainty. It follows, therefore, that means of intelligently interpreting and comparing actual operating results with forecasts must be devised.

In setting up our budget, as shown in our profit and loss forecast, Statement No. 23, all expenses were analyzed in the same minute detail and care as explained above for selling expenses, resulting in the profit and loss statements subjoined for the months of February and March.

	February	*March*	*March over February*	*Variable Expenses % Column 3 divided by $25,000*	*Variable Expenses Amount Column 4 × $250,000*	*Fixed Expenses Column 1 Minus Column 5*
Net Sales	$250,000	$275,000	$25,000			
Cost of Sales.....	$168,450	$182,975	$14,525	58.10	$145,250	$23,200
Selling Expenses ..	37,700	39,600	1,900	7.60	19,000	18,700
Administrative Expenses	29,500	31,400	1,900	7.60	19,000	10,500
Other Deductions..	8,400	9,200	800	3.20	8,000	400
	$244,050	$263,175	$19,125	76.50	$191,250	$52,800
Other Income.....	1,850	1,900	50	.20	500	1,350
	$242,200	$261,275	$19,075	76.30	$190,750	$51,450
Net Profit before Federal tax on income	$ 7,800	$ 13,725	$ 5,925			
Federal tax on income	1,073	1,887	814			
Net Profit	$ 6,727	$ 11,838	$ 5,111			

The fixed expenses amount to $51,450 and the variable are 76.30% of the net sales.

To prove the above statement, the results are summarized below:

	Sales	*Expenses*	*% of Variability*
March	$275,000	$261,275	
February	250,000	242,200	
	$ 25,000	$ 19,075	76.30%

	February	*March*
Net Sales	$250,000	$275,000
Total Expenses	$242,200	$261,275
Variable Expenses, 76.30% of sales	190,750	209,825
Fixed Expenses	$ 51,450	$ 51,450

To measure the efficiency or lack of efficiency in the results from operations for any month in any subdivision of expenses, apply the per cent of variability as determined (76.30% in total in our illustration) to the sales of the month, thereby determining what the variable expenses should have been. To this amount add the fixed charges, thereby obtaining total expenses by classification. If the results are not satisfactory, it will be necessary to prepare a detailed analysis of the sub-division of expenses which appear to be out of line.

The method above illustrated for predetermining expenses is used by our company. The satisfactory results obtained have far exceeded our expectations.

Sales Break-Even Point

The above data furnishes the basis for determining the break-even point on sales. To illustrate, using the figures arrived at above:

Variable expenses	76.30%
Allowance for fixed expenses and profit	23.70%
	100.00%

The net profit for the month of February amounted to $7,800, which, when divided by 23.70% gives the amount by which the sales may shrink to break even, or $32,911. The sales break-even point is therefore $217,089. To prove:

Sales	$217,089
Variable Expenses, 76.30%	165,639
Fixed Expenses	51,450
	$217,089

We prepare a profit graph, Exhibit 3, showing the anticipated profit or loss on sales up to $400,000 per month. This graph is revised when conditions make it necessary. Any variations from this forecast that may arise are analyzed monthly for presentation to the management.

NET PROFITS, WHEN, AS AND IF.

A GRAPHIC CHART THAT SHOWS AT WHAT POINT THEY SHOULD APPEAR.

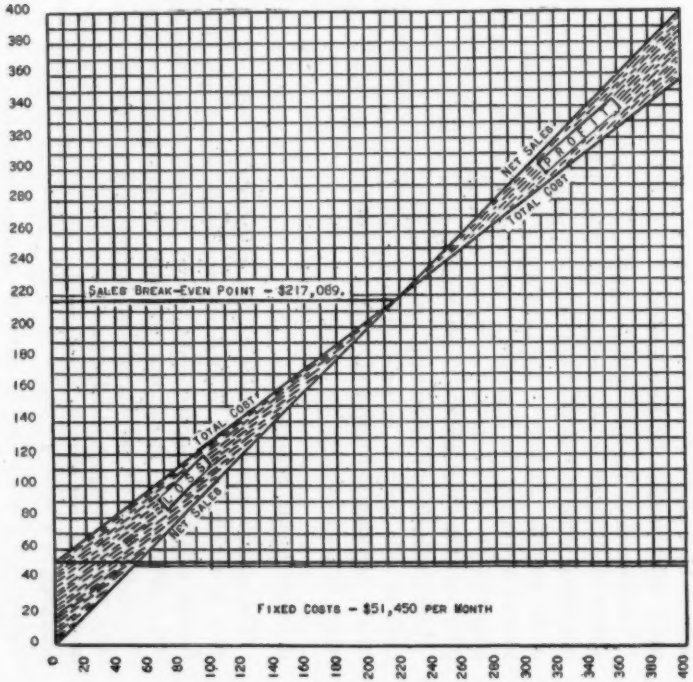

EXHIBIT 3

TO APPROXIMATE THE MONTHLY PROFIT OR LOSS

1. Take 76.30% of the net sales, thereby obtaining the variable expenses.

   To this product add the fixed expenses of $51,450, thereby obtaining the total costs.

   The difference between the total costs and the net sales is the net profit or net loss.

2. Take the difference between the net sales line and the total cost line.

This chart is based on our present costs and present sales prices.

Cash Receipts and Disbursements

In estimating cash receipts from sales we apply a certain ratio to the sales of the prior month, and also give due consideration and effect to any deviation that is likely to have an influence on the receipts based on the collection ratio resorted to. From a study of a number of years, we find that there is a fairly uniform relation between sales and collections, and that we can gauge with a considerable degree of accuracy the amount of probable collections in the succeeding month. It is sometimes necessary to adjust the anticipated receipts from sales as derived by the ratio; as where a relatively large invoice is not due for payment until after the normal due date on account of special conditions of the order. Our collections have slight seasonal trends, which makes it necessary to use a different ratio for each month.

Disbursements for pay roll are made at specific dates, either weekly, semi-monthly, or monthly. We check this figure by first estimating what the accrued pay roll will probably be at the end of the month. Adding to the earned pay roll of the month the amount accrued at the beginning of the month and subtracting the estimated pay roll at the end of the month should very closely approximate the direct method of determining pay roll disbursements.

Disbursements for accounts payable forecast, Statement No. 14, explains our method of predetermining disbursements for materials, expenses and supplies. Disbursement dates for taxes, interest, etc., are fixed.

Essential Budget Requirements

The main requirement of a budget is flexibility. The budget must be readily adapted to meet any conditions which may arise. Rightly conceived, a budget must furnish us the means of control and guidance for the effective operation of the business. Such control is impossible if the original budget is restrictive in character and not subject to adjustment where sound business judgment dictates that changes are desirable. In this connection I am reminded of a reply a learned attorney uses. "Consistency is the argument of a small mind." A budget system should be a servant, not a master. As some one has said, "Manage through your budget; don't let it manage you."

Circumstances beyond control that could not be contemplated in advance are certain to arise which will necessitate changes in the original forecast in the light of new conditions. We do not allow the budget to run us. In our company any emergency which may present itself is handled promptly without regard to the budget. Sales may exceed or fall short of expectations, necessitating changes in production schedules and the adjustment of all expenses to meet the changed condition.

Most budgets are unsupported by facts and represent "hoped for" expectations, or, "hunches," rather than real expectations of accomplishments; or, as too often is the case, they are prepared with the sole idea that they will be excelled.

Forecasts should not reflect desired conditions. The budget should be probable and possible of attainment. If time determines that the budget was improperly set, and that it either cannot be met, or is too easy to meet, interest in it is lost, with the result that department heads exert no effort towards efficiency and become disinterested in it.

Budget Benefits

The main benefits we derive from our budget are:

The preparation of a budget is educational; it is a very valuable "eye-opener."

It serves to establish a clear objective of performance.

It makes it necessary to consider expenses before they are incurred and to pass upon their justification within the amount appropriated.

It serves to fix responsibility if the anticipated results from operations are not met.

The knowledge that comparisons are being made between estimated and actual performance has a psychological effect on the departmental heads and acts as an incentive for them to strive towards efficiency. The check-up stimulates accuracy in forecasting and spurs endeavor to greater achievement.

It coordinates production and sales requirements, thereby keeping inventories down to a minimum and properly balanced.

It predetermines future operations, and, if anticipated re-

sults are not satisfactory, offers ample opportunity to take steps for their correction.

It conserves the assets of the business since it regulates expenditures within income.

Through it necessary financing, if any, can be predetermined.

It supplies the information through which production and employment may be stabilized.

Bankers look with favor upon business with an effectively operated budget and upon the results actually obtained compared with the forecast.

It simplifies adjustment to changes, even though drastic, in economic conditions.

Banks Interested in Forecasts

Many banks today are insisting that clients who apply for accommodation submit estimated financial statements. The banks aim to exercise reasonable care and good judgment when considering an application for a loan. The company's proven ability to budget and forecast accurately is an important factor in the bank's passing judgment upon the loan application.

Balance Sheet and Profit and Loss Forecasts

The 24 forecasts which follow represent forecasts for all the balance sheet and the profit and loss items leading up to the balance sheet forecast, Statement No. 22, and the profit and loss forecast, Statement No. 23. These forecasts indicate the basis and source of information used in compiling them, and indicate to which forecasts the amounts are carried. These statements should be self-explanatory and need no further elaboration. Since the balance sheet and the profit and loss statements are the financial statements showing the past activities of the business, it is consistent that anticipated financial statements be reflected in similar statements.

Conclusion

The budget plan is a prophetic set-up, the main object of which is to supply management with a tool for the attainment of management control. In itself, the budget is not a control; it does,

however, provide a means for executive action which produces control. It is essential that frequent comparisons be made between anticipated and actual performance.

If a business is to reach the desired objective, it must be fortified by a well-planned budget covering a definite future period. The installation and operation of the budget plan stimulates constructive thought. Furthermore by arousing latent initiative it creates interest throughout the organization, at times rising to a point of enthusiasm, to the lasting benefit of the company.

The budget is an outstanding development in modern business practice. The fact that it has made such a large contribution to the efficiency of management accounts for its increasingly widespread adoption. Business cannot remain static; it must either forge ahead or slip backward. To move forward it is necessary to adjust all operations of the business to the changing times and to maintain expenditures within the limits of income, thereby assuring attainment of the ultimate goal, i.e., growth and permanence with a satisfactory profit.

There is a very valuable asset which the balance sheet does not show, probably because it is entirely too intangible. This asset is quoted from a book by Sir Mart Jenkenson.

"In the value of a balance sheet
One asset is omitted.
And its worth I want to know,
That asset is the value
Of the men who run the show."

The budget is now in your hands; it's up to you to "run the show."

Statement No. 1 – Sales Forecast

BASIS OF INFORMATION		JANUARY	FEBRUARY	MARCH	CARRIED TO FORECAST OF
Past performance interpreted in the light of future expectations	Anticipated Sales	$260,000	$250,000	$275,000	Accounts Receivable Profit and Loss

Statement No. 2 – Cost of Sales Forecast

Sales forecast	Net Sales	$260,000	$250,000	$275,000	
	Direct Labor, 18% of Sales	$ 46,800	$ 45,000	$ 49,500	
	Direct Materials, 22½% of Sales	58,500	56,250	61,875	
	Indirect Factory Labor;				
	Fixed; Executives, $2,000 per month	2,000	2,000	2,000	
	Foremen, 1,000 per week	4,400	4,000	4,400	
Cost of anticipated sales based on inventory value or current costs	Variable, 62% of Direct Labor,	29,000	27,900	30,700	
	Factory Supplies and Expense;				
	Fixed; Taxes,	5,000	5,000	5,000	
	Insurance,	500	500	500	
	Light, Heat and Power,	7,500	7,500	7,500	
	Variable, 26% of Direct Labor,	12,200	11,700	12,900	
	Depreciation charged to Cost of Sales,	8,600	8,600	8,600	
	Cost of Sales,	$174,500	$168,450	$182,975	Inventory Profit and Loss

Statement No. 3 – Factory Production Forecast

Production coordinated with the anticipated sales of the budgeted period. The elements of cost to sales are based on inventory value or current costs.	Direct Labor, $11,000 per week,	$ 48,400	$ 44,000	$ 48,400	Accrued Payroll
	Direct Materials, 125% of Direct Labor,	60,500	55,000	60,500	Accounts Payable
	Indirect Factory Labor;				
	Fixed; Executives, $2,000 per month	2,000	2,000	2,000	Accrued Payroll
	Foremen, 1,000 per week	4,400	4,000	4,400	Accrued Payroll
	Variable, 62% of Direct Labor,	30,000	27,300	30,000	Accrued Payroll
	Factory Supplies and Expense,				
	Fixed, Taxes,	5,000	5,000	5,000	Accounts Payable
	Insurance,	500	500	500	Accounts Payable
	Light, Heat and Power,	7,500	7,500	7,500	Accounts Payable
	Variable, 26% of Direct Labor,	12,600	11,400	12,600	Accounts Payable
	Depreciation	8,600	8,600	8,600	
	Cost of Production	$179,500	$165,300	$179,500	Inventory

Statement No. 4 – Selling Expenses Forecast

BASIS OF INFORMATION		JANUARY	FEBRUARY	MARCH	CARRIED TO FORECAST OF
Estimated on basis of most recent experience and after giving due consideration to possible changes. The variability in expenses was determined to be 2% of sales and fixed expenses $12,300 per month.	Expenses, including taxes, but excluding depreciation,	$ 17,500	$ 17,300	$ 17,800	Accounts Payable
The payroll, which will not vary with sales, comprises: Paid weekly, $3,478 Paid monthly, 5,000	Salaries,	20,300	18,900	20,300	Accrued Payroll
Plant Ledger and Reserve for Depreciation forecast	Depreciation,	1,500	1,500	1,500	Reserve for Depreciation
		$ 39,300	$ 37,700	$ 39,600	Profit and Loss

Statement No. 5 – Administrative Expenses Forecast

Estimated on basis of most recent experience and after giving due consideration to possible changes. The variability in expenses was determined to be 2% of sales and fixed expenses $3,600 per month.	Expenses, including taxes, but excluding depreciation,	$ 8,800	$ 8,600	$ 9,100	Accounts Payable
The payroll, which will not vary with sales, comprises: Paid weekly, $3,478 Paid monthly, 5,000	Salaries,	20,300	18,900	20,300	Accrued Payroll
Plant Ledger and Reserve for Depreciation forecast	Depreciation,	2,000	2,000	2,000	Reserve for Depreciation
		$ 31,100	$ 29,500	$ 31,400	Profit and Loss

Statement No. 6 – Cash Forecast

BASIS OF INFORMATION		JANUARY	FEBRUARY	MARCH	CARRIED TO FORECAST OF
	Balance beginning of month	$267,000	$312,200	$284,200	
	Anticipated Receipts from;				
Accounts and Notes Receivable	Accounts and Notes Receivable	$250,000	$234,000	$270,200	
Miscellaneous Accounts Receivable	Misc. Accounts Receivable	2,200	2,200	2,200	
		$252,200	$236,200	$272,400	
		$519,200	$548,400	$556,600	
	Anticipated Disbursements for;				
Accounts Payable,	Accounts Payable,	$ 94,000	$111,000	$127,000	
Accrued Payroll,	Payroll,	113,000	118,200	117,500	
Accrued City and State taxes,	City and State taxes,	-	35,000	500	
Federal tax on income,	Federal tax on income,	-	-	2,500	
		$207,000	$264,200	$247,500	
	Balance end of month	$312,200	$284,200	$309,100	Balance Sheet

Statement No. 7 – Accounts and Notes Receivable Forecast

	Balance beginning of month	$500,000	$505,800	$517,800	
	Anticipated Charges for;				
Sales forecast	Net Sales	$260,000	$250,000	$275,000	
Basis current charges	Freight and Postage	2,000	1,900	2,100	Accounts Payable
Basis current charges	Interest	100	100	100	Other Income
		$262,100	$252,000	$277,200	
		$762,100	$757,800	$795,000	
	Anticipated Credits for;				
Based on prior month's sales	Cash Receipts,	$250,000	$234,000	$270,200	Cash
Based on experience	Discounts Allowed (1½%)	3,700	3,500	4,050	Other Deductions
Based on experience	Accounts Written Off (1%)	2,600	2,500	2,750	Reserve for Bad Debts
		$256,300	$240,000	$277,000	
	Balance end of month	$505,800	$517,800	$518,000	Balance Sheet

Statement No. 7 Continued – Reserve for Bad Debts Forecast

BASIS OF INFORMATION		JANUARY	FEBRUARY	MARCH	CARRIED TO FORECAST OF
	Balance beginning of month	$ 50,000	$ 50,000	$ 50,000	
Based on experience	Credits; Provision for possible loss 1%	2,600	2,500	2,750	Other Deductions
		$ 52,600	$ 52,500	$ 52,750	
Accounts and Notes Receivable	Charges; Accounts written off	2,600	2,500	2,750	
	Balance end of month	$ 50,000	$ 50,000	$ 50,000	Balance Sheet

Statement No. 8 – Miscellaneous Accounts Receivable Forecast

	Balance beginning of month	$ 1,000	$ 1,000	$ 1,000	
Basis current charges	Anticipated Charges for: Gasoline and oil sales	1,000	1,000	1,000	Accounts Payable
Basis current charges	Garage rentals to employees	200	200	200	Other income
Term of lease	Rent to tenants	1,000	1,000	1,000	Other income
		$ 3,200	$ 3,200	$ 3,200	
Charges paid monthly Term of lease	Anticipated Credits for; Cash Received from; Employees, $1,200 Tenants 1,000	2,200	2,200	2,200	Cash
	Balance end of month	$ 1,000	$ 1,000	$ 1,000	Balance Sheet

Statement No. 9 - Inventory Forecast

BASIS OF INFORMATION		JANUARY	FEBRUARY	MARCH	CARRIED TO FORECAST OF
	Balance beginning of month	$1,000,000	$1,005,000	$1,001,850	
Factory Production forecast	Factory Production	179,500	165,300	179,500	
		$1,179,500	$1,170,300	$1,181,350	
Cost of Sales forecast	Cost of Sales	174,500	168,450	182,975	
	Balance end of month	$1,005,000	$1,001,850	$ 998,375	Balance Sheet

Statement No. 10 - Deferred Charges Forecast

	Balance beginning of month;				
	Interest,	$ 3,000	$ 2,000	$ 1,000	
	Insurance, etc.	19,000	22,700	28,550	
		$ 22,000	$ 24,700	$ 29,550	
	Anticipated Charges;				
Notes Payable Register	Interest,	$ -	$ -	$ 6,000	Accounts Payable
Insurance Register, etc.	Insurance, etc.	15,700	17,850	15,000	
	Anticipated Credits;				
Monthly write off	Interest,	1,000	1,000	1,000	Other Deductions
Monthly write off	Insurance, etc.	12,000	12,000	12,000	Distributed to the various expenses
	Balance end of month;				
	Interest,	$ 2,000	$ 1,000	$ 6,000	
	Insurance, etc.	22,700	28,550	31,550	
		$ 24,700	$ 29,550	$ 37,550	Balance Sheet
	(a) Increase in Insurance, etc.	$ 3,700	$ 5,850	$ 3,000	Accounts Payable

(a) Only the increase or decrease in insurance, etc. is carried to the Accounts Payable forecast because the anticipated expenses in the Accounts Payable forecast of anticipated liabilities to be incurred are the actual expenses of the month and include book transfers for insurance, etc. Therefore, since the insurance, etc. which is absorbed in costs is included in the Accounts Payable forecast the amount not yet included must be similarly included.

Statement No. 11 – Fixed Assets Forecast

BASIS OF INFORMATION		JANUARY	FEBRUARY	MARCH	CARRIED TO FORECAST OF
	Balance beginning of month	$2,000,000	$2,004,000	$2,008,000	
Appropriation Schedule. It is assumed that all additions are made by the Company.	Anticipated Additions,				
	Labor,	$ 2,000	$ 2,000	$ 2,000	Accrued Payroll
	Materials and Supplies	2,000	2,000	2,000	Accounts Payable
		$ 4,000	$ 4,000	$ 4,000	
		$2,004,000	$2,006,000	$2,012,000	
Appropriation Schedule	Anticipated sales and other dispositions	-	-	-	
	Balance end of month,	$2,004,000	$2,008,000	$2,012,000	Balance Sheet

Statement No. 11 – Reserve for Depreciation Forecast

	Balance beginning of month	$ 500,000	$ 512,500	$ 525,000	
	Credits; Provision for depreciation charged to;				
Production	Cost of Sales, $ 8,600				
Administrative Expenses	Administrative, 2,000				
Selling Expenses	Selling, 1,500				
Idle Plant	Idle Plant, 400				
	$12,500	12,500	12,500	12,500	
		$ 512,500	$ 525,000	$ 537,500	
	Charges; Accumulated provision for depreciation on fixed assets disposed of.	-	-	-	
	Balance end of month	$ 512,500	$ 525,000	$ 537,500	Balance Sheet

Statement No. 12 – Notes Payable Forecast

	Balance beginning of month	$ 100,000	$ 100,000	$ 100,000	
Additional requirements	Additional bank borrowings	-	-	-	
		$ 100,000	$ 100,000	$ 100,000	
Excess cash requirements	Bank borrowings paid	-	-	-	
	Balance end of month	$ 100,000	$ 100,000	$ 100,000	Balance Sheet

Statement No. 13 – Accounts Payable Forecast

BASIS OF INFORMATION		JANUARY	FEBRUARY	MARCH	CARRIED TO FORECAST OF
	Balance beginning of month	$ 70,000	$ 90,000	$ 88,000	
	Anticipated Liabilities incurred;				
	Raw Materials,	$ 60,500	$ 55,000	$ 60,500	
Factory Production,	Factory Supplies and Expense,	25,600	24,400	25,600	
Factory Production,	Materials for fixed assets,	2,000	2,000	2,000	
Fixed Assets,	Selling Expenses,	17,500	17,300	17,800	
Selling Expenses,	Administrative Expenses,	8,800	8,600	9,100	
Administrative Expenses,	Freight, etc. charged customers,	2,000	1,900	2,100	
Accounts and Notes Receivable,	Gasoline, etc. sales to employees	1,000	1,000	1,000	
Miscellaneous Accounts Receivable,	Charges to Idle Plant,	1,000	1,000	1,000	
Idle Plant,	Increase in deferred charges,	3,700	5,850	3,000	
Deferred Charges,	Interest prepaid on notes,	-	-	6,000	
Deferred Charges,		$122,100	$117,050	$128,100	
	Deduct;				
	City and State taxes	7,500	7,500	7,500	
Taxes are included in above expenses, hence this liability is transferred to the Tax a/c					
Based on experience,	Discount on Purchases	600	550	600	Other Income
		$ 8,100	$ 8,050	$ 8,100	
		$114,000	$109,000	$120,000	
		$184,000	$199,000	$208,000	
Accounts Payable Disbursements,	Anticipated Disbursements,	94,000	111,000	127,000	Cash
	Balance end of month	$ 90,000	$ 88,000	$ 81,000	Balance Sheet

Statement No. 14 – Accounts Payable Disbursements Forecast

Accounts Payable	Balance of Accounts Payable at beginning of month,	$ 70,000	$ 90,000	$ 88,000	
	Eliminate items not currently payable;				
	Professional services,	$ 4,500	$ 5,000	$ 1,500	
	Capital Stock tax,	3,000	3,000	3,000	
		$ 7,500	$ 8,000	$ 4,500	
		$ 62,500	$ 82,000	$ 83,500	
	Accounts currently Payable, Also;				
Policy of paying all bills on due date and taking advantage of cash discounts	50% of materials purchased during the month	30,250	27,500	30,250	
Note Payable Register,	Interest on Notes Payable	-	-	6,000	
Based on experience,	Professional services,	--	--	4,000	
Insurance Register,	Insurance due during the month of renewal	1,250	1,500	2,250	
		-	-	1,000	
Subscription due date	Community Chest	$ 94,000	$111,000	$127,000	Accounts Payable

Statement No. 15 – Accrued Payroll Forecast

BASIS OF INFORMATION		JANUARY	FEBRUARY	MARCH	CARRIED TO FORECAST OF
	Balance beginning of month	$ 10,000	$ 24,400	$ 23,300	
	Anticipated earned Payroll:				
Factory Production	Direct Labor	$ 48,400	$ 44,000	$ 48,400	
Factory Production	Indirect Factory Labor	36,400	33,300	36,400	
Selling Expenses	Selling Salaries	20,300	18,900	20,300	
Administrati e Expense	Administrative Salaries	20,300	18,900	20,300	
Fixed Assets	Fixed Assets	2,000	2,000	2,000	
		$127,400	$117,100	$127,400	
		$137,400	$141,500	$150,700	
Estimated on basis of paying payroll in accordance with departmental schedule	Anticipated payroll disbursements	113,000	118,200	117,500	Cash
	Balance end of month	$ 24,400	$ 23,300	$ 33,200	Balance Sheet

Statement No. 16 – Accrued City and State Taxes Forecast

	Balance beginning of month	$ 50,000	$ 57,500	$ 30,000	
City and State Tax Schedule	Monthly accrual	7,500	7,500	7,500	Various expense accounts (See accounts payable)
		$ 57,500	$ 65,000	$ 37,500	
Taxes paid in accordance with terms of bills	Payments	–	35,000	500	Cash
	Balance end of month	$ 57,500	$ 30,000	$ 37,000	Balance sheet

Statement No. 17 – Federal Tax on Income Forecast (Prior Year)

	Balance beginning of month	$ 10,000	$ 10,000	$ 10,000	
Quarterly Payments	Payments	–	–	2,500	Cash
	Balance end of month	$ 10,000	$ 10,000	$ 7,500	Balance Sheet

Statement No. 18 – Federal Tax on Income Forecast (Current Year)

	Balance beginning of month	$ –	$ 1,141	$ 2,214	
Profit and Loss	Provision on current year's income	1,141	1,073	1,887	
		$ 1,141	$ 2,214	$ 4,101	Balance Sheet

Statement No. 19 – Other Income Forecast

BASIS OF INFORMATION		JANUARY	FEBRUARY	MARCH	CARRIED TO FORECAST OF
Accounts and Notes Receivable	Interest received or accrued	$ 100	$ 100	$ 100	
Miscellaneous Accounts Receivable	Rent from Tenants	1,000	1,000	1,000	
Miscellaneous Accounts Receivable	Garage rentals to employees	200	200	200	
Accounts Payable	Discount on purchases	600	550	600	
		$1,900	$1,850	$1,900	Profit and Loss

Statement No. 20 – Other Deductions Forecast

Accounts and Notes Receivable	Cash Discount allowed	$3,700	$3,500	$4,050	
Reserve for Bad Debts	Provision for bad debts	2,600	2,500	2,750	
Deferred Charges	Interest	1,000	1,000	1,000	
Idle Plant	Idle Plant	1,400	1,400	1,400	
		$8,700	$8,400	$9,200	Profit and Loss

Statement No. 21 – Idle Plant Forecast

Allocating to Idle Plant expenses determined to be chargeable thereto	Taxes, insurance, light, heat and power, etc.	$1,000	$1,000	$1,000	
Plant ledger and reserve for depreciation forecast	Depreciation	400	400	400	
		$1,400	$1,400	$1,400	Other Deductions Forecast

Statement No. 22 - Balance Sheet Forecast

BASIS OF INFORMATION - FORECAST OF		DECEMBER 31 actual	JANUARY 31	FEBRUARY 29	MARCH 31
	ASSETS				
	CURRENT ASSETS:				
Cash	Cash	$ 267,000	$ 312,200	$ 284,200	$ 309,100
Accounts and Notes Receivable	Accounts and Notes Receivable-net	450,000	455,800	467,800	468,000
Miscellaneous Accounts Receivable	Miscellaneous Accounts Receivable	1,000	1,000	1,000	1,000
Inventory	Inventories	1,000,000	1,005,000	1,001,850	998,375
		$1,718,000	$1,774,000	$1,754,850	$1,776,475
Deferred Charges	DEFERRED CHARGES	22,000	24,700	29,550	37,550
Fixed Assets	FIXED ASSETS - net	1,500,000	1,491,500	1,483,000	1,474,500
		$3,240,000	$3,290,200	$3,267,400	$3,288,525
	LIABILITIES				
	CURRENT LIABILITIES				
Notes Payable	Notes Payable	$ 100,000	$ 100,000	$ 100,000	$ 100,000
Accounts Payable	Accounts Payable	70,000	90,000	86,000	81,000
Accrued Payroll	Payroll Accrued	10,000	24,400	23,300	33,200
Accrued City and State Taxes	City and State Taxes	50,000	57,500	30,000	37,000
Federal Tax on Income	Federal Tax on Income:				
	Prior year	10,000	10,000	10,000	7,500
	Current year	-	1,141	2,214	4,101
		$ 240,000	$ 283,041	$ 253,514	$ 262,801
	NET WORTH:				
	Capital Stock:				
	6% Cumulative Preferred: Authorized, issued and outstanding, 10,000 shares with a par value of $100 each	$1,000,000	$1,000,000	$1,000,000	$1,000,000
	Common: Authorized, issued and outstanding, 40,000 shares with a par value of $25 each	1,000,000	1,000,000	1,000,000	1,000,000
Surplus Forecast	Surplus	1,000,000	1,007,159	1,013,886	1,025,724
		$3,000,000	$3,007,159	$3,013,886	$3,025,724
		$3,240,000	$3,290,200	$3,267,400	$3,288,525

Statement No. 23 - Profit and Loss Forecast

BASIS OF INFORMATION - FORECAST OF		JANUARY	FEBRUARY	MARCH	CARRIED TO FORECAST OF
Sales	Net Sales	$ 260,000	$ 250,000	$ 275,000	
Cost of Sales	Cost of Sales	174,500	168,450	182,975	
	Gross Profit on Sales	$ 85,500	$ 81,550	$ 92,025	
Selling Expenses	Selling Expenses	$ 39,300	$ 37,700	$ 39,600	
Administrative Expenses	Administrative Expenses	31,100	29,500	31,400	
		$ 70,400	$ 67,200	$ 71,000	
	Profit from Operations	$ 15,100	$ 14,350	$ 21,025	
Other Income	Other Income	1,900	1,850	1,900	
		$ 17,000	$ 16,200	$ 22,925	
Other Deductions	Other Deductions	8,700	8,400	9,200	
	Net Profit before Federal Tax on Income	$ 8,300	$ 7,800	$ 13,725	
	Federal Tax on Income- 13 3/4%	1,141	1,073	1,887	Federal Tax on income, current year.
	Net Profit	$ 7,159	$ 6,727	$ 11,838	Surplus

Statement No. 24 - Surplus Forecast

	Balance beginning of month	$1,000,000	$1,007,159	$1,013,886	
Profit and Loss	Net profit for the month	7,159	6,727	11,838	
	Balance end of month	$1,007,159	$1,013,886	$1,025,724	Balance Sheet

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